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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1990

ROCCO DiLEO and LOUISE DiLEO,

*Petitioners,*

v.

ERNST & YOUNG,

*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

**BRIEF IN OPPOSITION TO  
PETITION FOR WRIT OF CERTIORARI**

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**QUESTION PRESENTED**

Did the Court of Appeals correctly conclude that the factual allegations in the amended complaint failed to allege fraud with sufficient particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure?

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**BRIEF IN OPPOSITION TO  
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Respondent Ernst & Young ("E&Y") requests that this Court deny the petition for writ of certiorari, seeking review of the judgment of the Court of Appeals for the Seventh Circuit. (A1-A10).<sup>\*</sup> Petitioners ask this Court to review the allegations in their complaint and determine whether they have pleaded securities fraud with the particularity required

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<sup>\*</sup> Citations to "A\_\_" are to the Appendix accompanying the petition.

by Rule 9(b) of the Federal Rules of Civil Procedure. Despite an abundance of available information and an opportunity to replead,\* three courts have reviewed petitioners' initial and amended pleadings and concluded they were insufficient under Rule 9(b). No question of law, much less a conflict among the circuits, is presented, but only the application of established principles to these particular allegations.

### STATEMENT OF THE CASE

The amended complaint alleging securities law violations, on behalf of a putative class of purchasers, was brought against Continental Illinois Corporation ("Continental"), various officers and directors, and E&Y. The initial complaint was dismissed, pursuant to Rule 9(b), with leave to amend. Class certification was denied because the alleged class duplicated a previously certified class, which had settled. (A13-A14). E&Y moved to dismiss securities fraud, RICO, and common law fraud claims asserted against E&Y in the amended complaint; that motion was granted and the amended complaint was dismissed as against E&Y. Petitioners did not appeal the dismissal of the RICO and common law fraud claims. The only issue decided by the Seventh Circuit

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\* In dismissing petitioners' initial complaint against E&Y for failure to plead fraud with particularity, the district court noted that petitioners' failure to state their fraud claims with particularity was magnified by the fact that they "had access to discovery sufficient to allow them to plead with excellent specificity. The issues sought to be raised here were the subject of discovery in other cases and [E&Y's] general role in the Continental Bank affair was tried on the merits before Judge Grady of this Court in the Continental Illinois securities litigation [in which a jury rendered a verdict for E&Y]." *DiLeo v. Baumhart*, No. 84C7305, slip op. at 2 (N.D. Ill. May 2, 1988).

was the dismissal of the securities claims for failure to plead fraud with the particularity required by Rule 9(b).

The Court of Appeals carefully analyzed the amended complaint and distilled the allegations down to the essentials. (A4-6). The petition in this Court does not dispute the Court of Appeals' summary of those allegations.

Petitioners were shareholders of Continental. Respondent E&Y was Continental's independent auditor for the 1982 and 1983 fiscal years. The value of petitioners' shares fell as various loans in Continental's loan portfolio defaulted, and as Continental was required to raise its reserves for bad loans. The gist of petitioners' complaint was that Continental did not increase its reserve for bad loans quickly enough, and that E&Y "became aware that a substantial amount of the receivables reported in Continental's financial statements were likely to be uncollectible." (A4). As the Court of Appeals pointed out, however, the complaint failed to connect E&Y with any particular fraud:

"The story in this complaint is familiar in securities litigation. At one time the firm bathes itself in a favorable light. Later the firm discloses that things are less rosy. The plaintiff contends that the difference must be attributable to fraud. 'Must be' is the critical phrase, for the complaint offers no information other than the differences between the two statements of the firm's condition . . . . *It presents nothing other than the change in the stated condition of the firm to suggest that [E&Y] was so much as negligent in auditing Continental's financial statements.*" (A6) (emphasis supplied).

The Court of Appeals affirmed dismissal of the amended complaint, discussing separately the two legal theories upon which petitioners relied below. First, the court affirmed

dismissal of the claim of primary liability under the securities laws (*i.e.*, E&Y's certification of Continental's financial statements) because E&Y's alleged fraud was not pleaded with particularity. (A3-A6). "Rule 9(b) required the district court to dismiss the complaint, which discloses none of the circumstances that might separate fraud from the benefit of hindsight." (A6).

"You cannot tell from reading it why the DiLeos believe that the problems were so apparent that reserves should have been jacked up before the end of 1983 - why failure to increase the reserves amounted to 'fraud'. Fed. R. Civ. P. 9(b) requires the plaintiff to state 'with particularity' any 'circumstances constituting fraud'. Although states of mind may be pleaded generally, the 'circumstances' must be pleaded in detail. This means the who, what, when, where, and how: the first paragraph of any newspaper story. None of this appears in the complaint, although the flood of information released about Continental Bank since 1984 offers ample fodder if there is indeed a tale to tell." (A5-A6)

In affirming dismissal of the amended complaint for "direct" fraud by, or primary liability of, E&Y, the court did not mention, let alone address, the complaint's general allegation of scienter. (*See* A3-A6).

The Court of Appeals also addressed petitioners' claim that E&Y was secondarily liable under the securities laws for "aiding and abetting" the primary fraud of Continental (*i.e.*, E&Y's alleged failure to disclose Continental's fraud to the petitioners). The court affirmed the dismissal of this claim on two independent grounds: first, petitioners had not alleged an essential element of aiding and abetting liability (A8); and second, petitioners had failed to allege facts to suggest that

E&Y acted with the requisite scienter (A8-A10). Only the second of these grounds is questioned in the petition.

### **REASONS WHY THE PETITION SHOULD BE DENIED**

The petition should be denied. There is no conflict among the circuits concerning the "particularity" requirement of Rule 9(b) in fraud cases, even assuming that "particularity" constitutes an issue of sufficient national importance to suggest the necessity of the discretionary intervention of this Court. Rather, the only issue presented by the petition is whether the Court of Appeals correctly applied Rule 9(b) to the specific factual allegations in this complaint. Two courts have already conducted this fact-bound effort, and no justification exists for this Court to perform a third review. *Cf. Graver Tank & Mfg. Co. v. Linde Air Products Co.*, 336 U.S. 271, 275 (1949). Similarly, with respect to the allegation of scienter, review by this Court is unwarranted because petitioners have not sought review of the primary ground advanced by the Court of Appeals for dismissal of the pleading, and because the asserted conflict among the circuits does not implicate the decision below.

**1. Whether these allegations meet the "particularity" requirements of Rule 9(b) is a fact-based issue, correctly decided, and not worthy of review by this Court.**

The first issue addressed by the Court of Appeals was whether petitioners' allegations of E&Y's asserted direct or primary fraud in certifying the financial statements met the "particularity" requirement of Rule 9(b). The court reviewed those factual allegations in detail (A3-A4), and concluded, as quoted at pages 3-4, *supra*, that E&Y's alleged fraud had not been set forth with "particularity."

Petitioners suggest (Pet. at 8-10) that the Court of Appeals' explanation of the deficiency in this pleading - its failure to set forth the "who, what, when, where, and how" of E&Y's asserted fraud (A5) - constitutes a conflict among the circuits. Petitioners assert that other circuits "require only identification of the time, place and nature of the fraudulent conduct." Pet. at 9 (emphasis supplied). But petitioners cannot construct a conflict among the circuits by juxtaposing "who, what, when, where, and how" against "time, place, and nature." That is especially true because petitioners do not attempt to explain how the disposition here, based on the allegations in the amended complaint, would be any different even if the Court of Appeals had applied the allegedly "different analysis" urged by them.

As shown by the cases petitioners cite, a detailed analysis of the factual allegations of the particular complaint is the heart of a Rule 9(b) analysis. For example, in *Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d 96 (CA 3 1983), Pet. at 6, the complaint alleged that the Trust's reported reserve for bad loans was understated and that defendants (including an accounting firm) knew that deceptive accounting measures disguised the Trust's true financial condition. As in this case, the loans apparently went bad and plaintiffs lost money. The court affirmed dismissal of the complaint pursuant to Rule 9(b) because it did not disclose "the manner in which, in establishing reserves for bad debts in the financial statements relied upon, the defendants knowingly departed from reasonable accounting practices." *Id.* at 100. See also, cited in Pet. at 6, 9, *Seattle-First National Bank v. Carlstedt*, 800 F.2d 1008, 1012 (CA 10 1986) (Moore, J., dissenting) (agreeing with majority's legal analysis of Rule 9(b), but disagreeing with majority's application of it to the factual allegations of the complaint).

The Court of Appeals did not, as petitioners suggest (Pet. at 9), create any "pleading standard" that Rule 9(b) requires the pleading of evidence. In illustrating the deficiency of this pleading in failing to "particularize" the "circumstances" of E&Y's asserted fraud, the court merely observed that the complaint did "not [refer to] a single concrete example" of a "reserve" that should have been taken, a "bad loan," or a "non-performing loan." (A4). Far from creating a new "pleading standard" (Pet. at 9), the decision of the Court of Appeals simply sifted through the allegations in this complaint, concluded that the circumstances of E&Y's asserted fraud had not been set forth with particularity, and applied the general rule that conclusory allegations of fraud are insufficient. *See, e.g., Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 489 (CA 6 1990); *Smith v. Ayres*, 845 F.2d 1360, 1365 (CA 5 1988); *Semegen v. Weidner*, 780 F.2d 727, 731 (CA 9 1985); *Hayduk v. Lanna*, 775 F.2d 441, 444 (CA 1 1985); *Utah State University v. Bear, Stearns & Co.*, 549 F.2d 164, 170-71 (CA 10), *cert. denied*, 434 U.S. 890 (1977).

**2. Whether there is any conflict concerning the allegation of scienter under Rule 9(b) is not a question presented by this petition or implicated by the decision below.**

The Court of Appeals next addressed the insufficiency of petitioners' allegations in this complaint that E&Y was secondarily liable under the securities laws for assertedly aiding and abetting the primary fraud of Continental. (A6-A10). In the context of secondary liability, the court wrote that this complaint did not provide any "basis for believing that [petitioners] could prove scienter." (A9). From that reference, petitioners assert that the Seventh Circuit adopted a Second Circuit standard of pleading scienter, which conflicts with other circuits, and should be resolved by this Court. Pet. at 7-8.

Before addressing the question of procedure raised in the petition, we observe that an alternative ground for the judgment exists as to which petitioners have not petitioned for review. Petitioners' underlying claim against E&Y was for assertedly aiding and abetting. We note that the Court would initially have to decide the substantive issue, twice specifically reserved by the Court, of whether there is aiding and abetting liability at all under § 10(b) of the Securities Exchange Act and Rule 10b-5. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191 n.7 (1976); *Herman & Maclean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983).

Assuming *arguendo* for purposes of this brief only that such liability exists,\* petitioners fail to mention that the court below affirmed the dismissal of the complaint for two separate and independent reasons. The court first held that the complaint failed to allege an essential element of aiding and abetting liability (some legal or factual basis that E&Y owed a duty to inform petitioners of Continental's primary fraud). (A6). Petitioners did not seek review of that determination. Because this ground—the first discussed by the Court of Appeals—is conclusive of this case without even reaching the Rule 9(b) issue that the petition seeks to raise, review by this Court is inappropriate and unnecessary. *Cf. New York v. Uplinger*, 467 U.S. 246 (1984) (certiorari dismissed as improvidently granted); *The Monrosa v. Carbon Black Export, Inc.*, 359 U.S. 180 (1959) (same).

With respect to the procedural question petitioners present, the court's additional ground for dismissing this claim, that petitioners failed to allege any facts suggesting scienter in a

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\* E&Y, in support of the judgment below, would argue that there can be no liability for aiding and abetting under § 10(b) and Rule 10b-5.

secondary liability context, does not warrant review by this Court. Petitioners' suggestion that the Court of Appeals adopted a Second Circuit interpretation of Rule 9(b), which they contend conflicts with the Third and Tenth Circuits' interpretation of the Rule, is a house of cards.

We note initially that the Court of Appeals did not purport to join the Second Circuit in any unique position regarding the pleading of scienter and did not cite or rely on a single Second Circuit decision on this issue. If in fact a conflict exists between the Second Circuit and other courts of appeals, the Court will have enough time to resolve the issue in a case squarely adopting the Second Circuit's assertedly different approach.\* Finally, even assuming Second Circuit decisions might conflict with those of other circuits where primary liability is involved, the court below did not adopt (or purport to do so) a rule requiring the pleading of facts supporting an inference of scienter in primary liability cases. Rather, in the context of a claim of secondary liability under the securities

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\* We also note that the asserted conflict appears to be more a matter of semantics than results. The Second Circuit recognizes that "it would be unworkable and unfair to require great specificity in pleading scienter, since 'a plaintiff realistically cannot be expected to plead a defendant's actual state of mind.'" *Stern v. Leucadia National Corp.*, 844 F.2d 997, 1004 (CA 2) (quoting *Connecticut National Bank v. Fluor Corp.*, 808 F.2d 957, 962 (CA 2 1987)), *cert. denied*, 488 U.S. 852 (1988). The court requires that "circumstances must be pleaded that provide a factual foundation for otherwise conclusory assertions of scienter." *Id.* See also *Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (CA 2 1979), *cert. denied*, 446 U.S. 946 (1980). Although that formulation of the Rule apparently is unique to the Second Circuit, it merely amplifies Rule 9(b)'s first requirement that the *circumstances* of the fraud be pleaded with particularity; if the circumstances are so pleaded, a general averment of scienter will suffice in any circuit. See, e.g., *Cosmas v. Hassett*, 886 F.2d 8, 12-13 (CA 2 1989); *Goldman v. Belden*, 754 F.2d 1059, 1069-70 (CA 2 1985).

laws, the court determined that petitioners' pleading, including its averment of scienter, was insufficient under Rule 9(b) because it failed to connect E&Y with any fraud by Continental and because petitioners' conclusory aiding and abetting claim appeared irrational on its face. A9-A10. In the context of secondary liability, this approach is accepted, *see, e.g., Smith v. Ayres*, 845 F.2d 1360, 1365 (CA 5 1988) (dismissing an aiding and abetting claim under Rule 9(b) because it "alleged no facts supporting an inference of substantial or knowing assistance"), is endorsed by the treatise petitioners cite, *see* 2A J. MOORE & J. LUCAS, *MOORE'S FEDERAL PRACTICE* ¶ 9.03[3], at 9-47, 9-48 (2d ed. 1990) (Pet. at 7) ("Allegations of aiding and abetting must describe the fraud aided and set forth the circumstances demonstrating that the defendant knowingly rendered substantial assistance to the fraud"), and does not conflict with the cases petitioners cite. *See Seattle-First National Bank v. Carlstedt*, 800 F.2d 1008, 1011 n.2 (CA 10 1986) (Pet. at 6, 9) (upholding sufficiency under 9(b) of primary fraud allegations, but noting that "to the extent the counterclaim and amended counterclaim seek to impose aiding and abetting liability under the securities laws . . . based on routine participation in the loans to defendants, such claims would not satisfy Rule 9(b)"); *Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d 96, 98-100 (CA 3 1983) (Pet. at 6) (dismissing primary fraud claims under Rule 9(b); no mention of any aiding and abetting claims); *Cramer v. General Telephone & Electronics Corp.*, 582 F.2d 259, 273 n.17 (CA 3 1978) (Pet. at 6) (withholding decision as to whether complaint adequately alleged scienter as to accounting firm).

## CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be denied.

DATED: New York, New York  
October 10, 1990

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